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ECONOMIC UPDATE: WHY DIVIDENDS? WHY NOW?

Let the good times roll. For the past 13 months, investors have seen a rebound in equity valuations that rival any bull market over that past 100 years. Stocks have shaken off the recession, and are clearly forecasting better times ahead. Battered financials, small-cap stocks, and deeply flawed securities have led the way out of the abyss. The Russell 2000, a measure of the market returns from small publicly traded companies, has returned over 60% in the past year. The Dow Jones Financial Sector index is also up a whopping 75% in the past 12 months. The problems in the financial sector have been well chronicled, but a bull market often shrugs off bad news. As investment managers, we are enthusiastic about the rise in equity prices, but are focused on maintaining appropriate levels of portfolio risk. In Cutler's view, a strong dividend history is the best way to manage the risks that are often discarded when the economy is growing. Despite underperforming the market over the past year, now is not the time to abandon dividend-paying securities. The argument for dividends remains as prescient today as ever. We've highlighted a few of the more salient dividend-investment arguments below:

*Re-invested dividends
have historically
accounted for nearly
40% of investor total
return.*

Risk aversion - While fear has abated, risk remains for equity investors. Questions remain about the impact of the Greek debt crisis, commercial real estate, and government policies both here and abroad. While uncertainty clouds the value of any investment, dividends are real returns for investors. The benefits of dividends during a down market were demonstrated in Cutler's Equity Income strategy during the bear market of 2008, as the dividend paying companies held in the portfolio generally outperformed. The portfolio "beta," a measure of risk, remains at about 90% of the S&P 500's level of risk. Given the strong market returns of the past year, investors would be well-served to reduce risk in their portfolios at this time.

Compounding - Dividends have historically accounted for nearly 40% of the total return from equities. While dividend yields today generally average 2-3%, the compounding value of a company's dividend payment, especially with an increasing dividend stream, creates substantial value for long-term investors. Cutler believes that consistent and increasing dividend payments give investors confidence in the company's business model, but most importantly generate very strong compounding affects in an investor's portfolio.

Dividends are on the rise - In the first quarter of 2009, publicly traded companies decreased their dividend payments by nearly \$44 billion. In the first quarter of this year, the indicated increase was \$6.4 billion. Companies once again have positive earnings momentum. The rise of stock prices is not exclusive of a simultaneous rise in dividends; as dividend-focused investors, this is great news.

Today's market is very similar to the post-technology bubble market experience in the early 2000's. That market was fueled by Federal Reserve liquidity, as Alan Greenspan kept rates artificially low to abate deflation. Securitization allowed this liquidity to flow into the real estate market, creating a well-documented bubble. Today, securitization markets have disappeared, and money is looking for a place to flow. The obvious candidate has been stocks, and the market has risen accordingly. In our view, this rise can continue for some time, but investors would be well served approaching equities with a bias toward staying conservative.

*“When you earn a dollar, it has gained your respect.
When you invest that dollar, the investment should reflect your respect.”*

- Kenneth R. Cutler



"PAYING DIVIDENDS"

REFERRAL OPPORTUNITIES: THE BEST COMPLIMENT OUR CLIENTS CAN GIVE...

Talking with our clients is the best part of my day. It is a joy to hear about their plans for retirement, the excitement of their kids' going to college, or the fun plans they have to remodel their house. It is also great to hear how much they appreciate Cutler's role in helping them reach those goals. While we are saddened at the passing of a client, we are honored that so many of the "next generation" have elected to stay with us. All of us at Cutler are proud of the long-term relationships we have established with our clients.

We believe this is a testament to our fiduciary approach to managing our clients' assets. We think we are unique in that our investment personnel are accessible to our clients and are held accountable by these personal relationships. Perhaps the Wall Street meltdown of 2008 could have been avoided if the managers at large Wall Street banks had a relationship with the counterparties they were selling toxic assets to!

If you have a friend or colleague that you think could benefit from Cutler's investment approach and commitment to client service, please pass our name along or let us know. After all, a referral is the best compliment our clients can give.



Carol Fischer
Chief Operating Officer

"Paying Dividends" is a regular contribution to Cutler's Quarterly Newsletter and features rotating authorship by members of the Cutler team, presenting on topical subject matter. Look for Keegan Denn's article in our 3rd Quarter-2010 newsletter.

LIFESTYLE REBALANCE - 2010 CHANGES

Cutler recently completed the periodic rebalancing of our Lifestyle strategies, which are our risk-based portfolio models. While the investment process is largely quantitative, relying on historical correlation analysis, the introduction or removal of asset classes provides an opportunity to guide the analysis along investment themes that Cutler deems important. A change of note in the most recent rebalancing was the initial inclusion of the Treasury Inflation Protected Securities in the portfolio model. This fixed income asset class, often called TIPS, has a valuation anchored to Consumer Price Index (CPI) changes. If, for example, the CPI increases 5%, the principal value of the underlying bond would also increase 5%. Investors are protected from deflation, as the bond upon maturity pays the greater of the initial principal or the CPI adjusted amount. For Lifestyle portfolios with fixed income exposure, Cutler clients will notice TIPS as an allocation in their portfolio for the first time.

Cutler continues to believe that the Federal Reserve's extended zero-rate policy will generate inflation. While inflation has not shown up in measures such as the CPI as of yet, it can be argued that the extended rally of equities is partially a liquidity driven phenomenon. The introduction of this tool into our Lifestyle portfolios provides additional fixed income diversification for clients when inflation does return.



GLOBAL MARKET UPDATE

GLOBAL DEVELOPMENTS: CONFIDENCE IN GREECE COLLAPSES

The primary global development in the first quarter was the loss of confidence in Greece's sovereign debt. Amid the loss of market confidence in Greece's austerity program and only after the cost of its debt soared, the European Union (led by Germany) reluctantly agreed to provide Greece with €30 billion in funds at 5% interest per annum to refinance its upcoming maturities. When adding in the €15 billion in additional support from the IMF, the risk of a Greek default is now minimal. The European goal was not only to help Greece, but to also prevent other European debt-ridden countries, known as PIIGS (Portugal, Ireland, Italy, Greece, and Spain), from incurring a loss of market confidence. To get around EU governance rules forbidding such a bail-out, it was argued that Greece's problems were mostly caused by external market liquidity events. Greece was able to refinance some maturing debt on its own, but at much higher spreads than that available to countries like Germany. Having joined the Euro in 2001, Greece no longer had the luxury of simply devaluing its currency. Joining the Euro enabled it to lower funding costs, yet also put it on a path towards more spending and an eventual deterioration of its public finances. Greece now needs to implement a cost cutting program and raise taxes to balance the budget. With 700,000 public-sector workers and a very generous retirement system where pensioners earn 96% of their pre-retirement income, the government plans to increase the minimum retirement age from 58 to 65. The gross debt to GDP ratio, currently well over 100%, is higher than the Euro-average of 78%. Despite its debt percentage being in-line with that of Italy and lower than Japan's at 190%, Greece does



not have a very liquid market and/or the ability to self-finance as the country has a low savings rate. The problems with Greece highlight that fact that there is no formalized mechanism for Euro members to deal with internal imbalances. While a German led bailout may abate today's contagion risks, a long-term solution will be necessary to provide sovereign flexibility to avoid these imbalances in the future.

In Asia, however, China is grappling with the problem of containing an asset bubble. This problem is a luxury the European bureaucrats would definitely envy! Chinese government officials have urged banks to raise additional capital, increase borrowing rates, and refuse lending to speculators. The markets also believe that these actions could signal rising bad loans ahead, especially when banking regulators are requiring reserves equivalent to 200% of non-performing loan balances. To rebalance its economy, China needs to revalue the Yuan, which would have the effect of lowering exports. Conversely, this would raise imports, and most importantly, increase domestic demand as a stronger currency would make its citizens feel richer. The stronger currency would also keep foreign trade partners happy, as the US government has delicately prodded Chinese officials to strengthen their currency for several years.

Going forward, we believe that the domestic US market remains attractively valued. North American markets are demonstrating relative value from a quality and valuation perspective. Our global equity strategy, however, continues to be managed from a fundamental basis and remains agnostic to geographic constraints. This allows Cutler to invest in attractively valued securities, despite the headwind a specific country may be facing.



FIXED INCOME UPDATE

FIXED INCOME: WHERE DO WE GO FROM HERE?

With the Treasury sector as the only exception, the last 12 months have produced exceptional results for fixed income securities. The speed at which yield spreads narrowed was surprising given the economic turmoil and uncertainty. However, low yields have catapulted investors in search for higher yielding sectors. The spread compression appears to be a greater opportunity to sell these riskier sectors than to be buying into the euphoria. The largest risk for Cutler's fixed income portfolios would appear to be the loss of yield in a very low interest environment, but this interest environment also does not provide much cushion in a credit-widening event, or if interest rates rise considerably. As the year 2010 unfolds, neutrality versus the benchmark may reveal itself the best strategy, as we believe reaching for yield would bring unattractive interest rate risk into the portfolio.

The First Quarter of 2010 continued on the same path as the previous two quarters, as the credit sector outperformed the Treasury sector. CMBS continued its torrent pace, outperforming all other sectors by over 6.5% with a total return of 9.1% for the first quarter. The corporate sector also posted strong results in comparison, generating a 2.48% return. These strong results are the result of the continued tightening of yield spreads between the government sectors and the higher yielding sectors.

The members of the Federal Open Markets Committee (FOMC) have made it clear they have no intention of raising rates at this time. This is despite continued strength from economic reports. The March ISM non-manufacturing survey showed that growth of both activity and

new orders continued to broaden across industries toward the end of the quarter. There are many more critical economic releases coming in the next few weeks, which will provide greater insight into the strength and depth of this economic recovery. Continued strength may provide the

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Federal Reserve some interest rate flexibility. A continuation of the subdued inflation environment would also benefit the Fed's "go slow" approach to the economic recovery. Given the current interest rate environment and inflation readings, we continue to believe the best fixed income opportunities are in the "belly" of the yield curve, and continue to focus on 3-7 year maturities. We continue to believe fixed income investors should remain conservative versus the industry benchmarks.

